NSI DECISION MEMO

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NSI POLICY BRIEF: RESTRICTING U.S. OUTBOUND INVESTMENT TO TARGETED CHINESE SECTORS

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THIS NSI DECISION MEMO

1 **SUMMARIZES** the threat to U.S. national security from outbound investment to Chinese companies.

2 **DETAILS** current efforts by the Biden Administration to prohibit investments in certain technological areas of the Chinese economy.

3 **OUTLINES** policy recommendations to restrict U.S. investments into selective Chinese industries that could compromise U.S. national security.

Background

THE LOOMING CHINESE COMMUNIST PARTY THREAT

- **Able and Ready Peer Competitor.** The Biden Administration's National Security Strategy (NSS), published in October 2022, notes that China has become the only competitor to the United States with both the expressed intent to expand its role in international affairs and the economic, military, diplomatic, and technological means to do so.
- **Inbound Investment and CFIUS.** The Committee on Foreign Investment in the United States (CIFIUS) was originally created via Executive Order by President Gerald Ford in 1975 with limited authority and scope to review foreign investment. In 2018, Congress expanded the jurisdictional scope of CIFIUS to include joint venture, and certain real estate and other key transactions which were previously missing from its mandate.[1] CIFIUS can now more effectively assess inbound investment into the United States from countries of concern like China, Russia, Iran, and North Korea.
- **Outbound Investment Threat.** However, CFIUS does not review outbound capital flows from the United States to companies in countries like China. That gap presents a national security threat because U.S. capital could be used to assist the Chinese Communist Party (CCP) to dominate strategically important sectors involving semiconductors, artificial intelligence, quantum computing, decryption, and other advanced technologies. U.S. companies spent $11 billion buying or investing in Chinese companies last year alone.[2]
    - Members of Congress have highlighted the threats that outbound investments flowing to China, and by connection to the CCP, pose to the United States' national security. For example, Senator Marco Rubio, Vice-Chairman of the Senate Select Committee on Intelligence, remarked on recent estimates that nearly $2 trillion of U.S. investment money has been given to Chinese companies - allegedly some who have ties to the CCP and military development "designed to kill American soldiers, sailors, and Marines."[3]

CONGRESSIONAL ACTION

- **Reviving Oversight.** Since 2018, Congress has attempted to address similar concerns and restrict U.S. foreign investments, especially those headed to China.
  - Congress considered legislation that would have imposed restrictions on outbound investments, but ultimately dropped it from the CHIPS and Science Act of 2022 amid concerns that such restrictions would generate uncertainty in the investment and business communities, harm U.S. competitiveness abroad, and needlessly restrict capital flows and U.S. leadership in foreign investments – a noted area of U.S. international influence.[4]
  - During the 117th Congress, a bipartisan group of Congressional leaders called on President Biden to issue an executive order to accomplish outbound investment screening – an order that is thought to be shortly forthcoming.

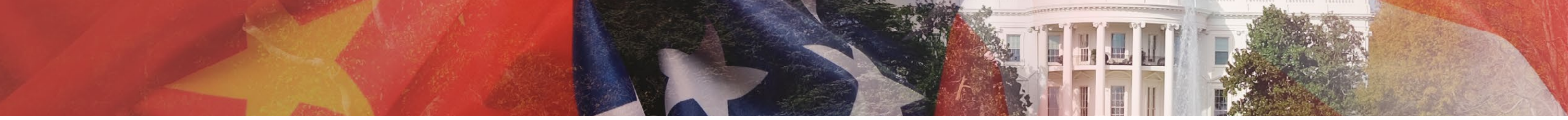
THE BIDEN ADMINISTRATION'S EFFORTS TO DATE

- **Treasury and Commerce Departments Initiatives.** As highlighted in a recent Department of Commerce budget Fact Sheet, the Administration is "considering the establishment of a program to address national security risks associated with outbound investments, which would prevent U.S. capital and expertise from financing advances in critical sectors that undermine U.S. national security while not placing an undue burden on U.S. investors and businesses."[5]
  - More recently, the 2023 Consolidated Appropriations Act included language that gave the U.S. Departments of the Treasury and Commerce (the Departments) $10 million each to identify what it would take to implement a program to address national security threats from "outbound investment" in certain sectors.[6]
    - On March 3, 2023, the Departments delivered their reports (the Reports) to Congress. The Reports state that the Administration is considering a new targeted regulatory approach to address U.S. investment in advanced technologies abroad that "could result in the advancement of military and dual-use technologies by countries of concern" which could pose national security risks.[7] The Reports did not identify specific technology sectors that the Administration considered of risk.

Authors' Views

U.S. NATIONAL SECURITY OVER FOREIGN INVESTMENT PROFITS

- **Wrong Once.** The West funded China's rise under a mistaken idea that increased engagement with China would lead to political and economic reforms. The opposite has proven true. Any engagement with China must be viewed through the reality of the situation and consider U.S. capital outbound investments to China in key areas as undermining the national security interests of the United States and its allies.
- **Administration Realities.** The NSS specifically mentions the 'screening of outbound investment' as a means to address threats to U.S. national security" from investments in certain advanced technology areas of the Chinese economy. The Administration is considering new authorities to prohibit investments in specific sectors in order to address concerns that the investments and exposure of intellectual property, as well as transfers of intangible expertise to foreign entities, could help our primary geopolitical adversaries develop and advance their technological knowledge and capabilities to threaten U.S. national security.
- **Upcoming EO.** The Biden Administration is expected to release an Outbound Investment Executive Order (EO) in the near future.



OVERSEEING OUTBOUND INVESTMENT

- **Not a Novel Concept.** Executive and legislative branch interest in an outbound investment review system is not a novel concept.[8] Similar efforts exploring the intersection of national and economic security issues have been debated since the earliest days of the Republic.[9]

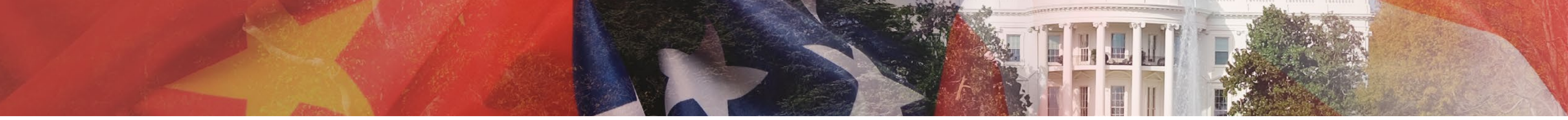
PRIVATE SECTOR IMPLICATIONS

- **Private Sector Response.** Some investment groups are already consulting independent national security experts to vet new China technology investments to help them better understand the many nuanced facets of the larger U.S.-China relationship.[10] Other international companies with production facilities in China have already accelerated plans to relocate their supply chains outside of China.[11]
- **Private Sector Uncertainty.** Uncertainty about U.S.-CCP relations has already impacted the flow of U.S. capital to Asia. U.S. private equity investments in Chinese companies declined to 0.29% worth of deals in 2022, compared to 1.19% in 2012.[12] Still, in 2021, the cumulative U.S. portfolio investment in China and Hong Kong was approximately $1.18 trillion, according to data recently published by the U.S. Department of the Treasury.[13] It remains, however, an open question where, specifically, many of those investments go or how they are utilized.
- **New Chinese Anti-Espionage Law Raises Additional Concerns.** China's recent amendments to its anti-espionage law, which broadens both the definition of espionage and government investigative powers, only add to the uncertainty. The amended law raises concerns that routine business activities and information gathering activities will now be included in the broader definition of espionage. Detentions of employees at foreign companies and visits and searches by Chinese authorities of those companies' offices in Hong Kong, Shanghai, and Beijing, have only added to the uncertainty of doing business in China and underscore the increasingly hostile environment confronting those companies.

Actionable Recommendations

1 FINALIZE EXECUTIVE ORDER

- The Administration should finalize a proposed outbound investment EO.
  - At a minimum, the EO should prohibit U.S. persons from investing any money in China in any of the critical national security technology areas as identified in The National Science and Technology Council's Critical and Emerging Technologies List Update, last updated in February of 2022.
  - The EO should restrict investment in any technology that is used by the CCP to repress their own people to export such repression globally, including enabling technologies.
  - Intentional violations of the EO ought to be actionable and the White House should work with Congress to enact mandatory monetary penalties for such violations.
- The Administration should resist attempts by Wall Street, Silicon Valley, Hollywood, and other centers of power to weaken the proposed rules throughout the process and see them through to implementation.
- Identify a "No Go list" of countries that would trigger an automatic review of outbound investment.



2 INITIATE MULTILATERAL OUTBOUND INVESTMENT REGIME

- The National Security Council and the Department of State should initiate a multilateral outbound investment regime to align and unify outbound investment protocols from allied democratic nations to be applied to authoritarian states like China, Iran, North Korea, and Russia.
- This new regime should be modeled after successful efforts across multiple administrations from both parties to align the export control regimes to prohibit critical technologies from going to countries of concern like China and Russia. Successful examples of these regimes are in the area to restrict access by Chinese telecommunications giants Huawei and ZTE, as well as limiting access to sophisticated technologies going to Chinese domestic semiconductor companies.

3 U.S. INVESTORS AND COMPANIES TAKE NOTE

- In anticipation of this new regulatory scheme, U.S. investors and companies with facilities, investments, or joint ventures in China, will need to reevaluate not only their investment strategies for the future, but also their current operations and commitments in sectors of the Chinese economy that affect U.S. national security interests.

Endnotes

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1 James Jackson, Cong. Research Serv., RL33388, The Committee on Foreign Investment in the Unites States (CFIUS) 37 (2020).

2 Ana Swanson and Lauren Hirsch, *U.S. Aims to Curtail Technology Investment in China,* The N.Y. Times (Feb. 9, 2023), https://www.nytimes.com/2023/02/09/business/us-china-investing-tech-biden.html.

3 Kristen Altus, *Republican Senator Sounds Alarm Over US, China War: 'Conflict's Already Here*,' Fox Business (Mar. 1, 2023), https://www.foxbusiness.com/politics/republican-senator-sounds-alarm-us-china-war-conflict-already-here.

4 Inu Manak, *Outbound Investment Screening Would Be a Mistake*, Council on Foreign Relations (June 30, 2022), https://www.cfr.org/article/outbound-investment-screening-would-be-mistake; *See also*, *ITI Cautions New Outbound Investment Provisions in Bipartisan Innovation Act Could Undermine U.S. Competitiveness*, Information Technology Industry, (May 3, 2022), https://www.cfr.org/article/outbound-investment-screening-would-be-mistake (referencing ITI letter to U.S. lawmakers expressing concern over legislation seeking to impose outbound investment restrictions and notification requirements).

5 *President Biden's Fiscal Year 2024 Budget Would Bolster Key Commerce Department Initiatives*, U.S. Dep't of Commerce (March 9, 2023), https://www.commerce.gov/news/press-releases/2023/03/president-bidens-fiscal-year-2024-budget-would-bolster-key-commerce.

6 *See* 198 Cong. Rec. S7819 (2022); 198 Cong. Rec. S8479 (2022).

7 Unclassified Official Use Only (citing Consolidated Appropriations Act, 2023 (P.L. No. 117-328 (Dec. 29, 2022))); Grant Harris & Diane Farrell, Int'l Trade Admin., Outbound Investment Initiative: Report to Congress (2023) pursuant to Consolidated Appropriations Act, 2023, Pub. L. No. 117-328, (2023).

8 For example, in 1968, President Johnson issued Executive Order 11387 (EO), "Governing Certain Capital Transfers Abroad," which established an outbound investment process administered by the Office of Foreign Direct Investments within the Department of Commerce. The EO declared, in part, "Any person subject to the jurisdiction of the United States who, alone or together with one or more affiliated persons, owns or acquires as much as a 10% interest in the voting securities, capital or earnings of a foreign business venture is prohibited on or after the effective date of this Order, except as expressly authorized by the Secretary of Commerce, from engaging in any transaction involving a direct or indirect transfer of capital to or within any foreign country or to any national thereof outside the United States." *See* Exec. Order No.11387, 33 F.R. 47 (1968) amended in 12 U.S.C. § 95a. The effort, however, did not take hold, and President Reagan revoked the EO in 1986 through Executive Order 12553. *See* Exec. Order No. 12553 3 C.F.R. 302 (1980).

9 *E.g.,* At President Jefferson's request, Congress passed the Embargo Act of 1807, which closed all U.S. ports to export shipping in either U.S. or foreign vessels, and restrictions were placed on imports from Great Britain. *See* Embargo Act of 1807, 2 Stat. 451 (1807).

10 Aruna Viswanatha et al., *Sequoia Turns to Outside National-Security Experts to Vet New China Tech Investments*, Wall St. J. (Feb. 24, 2023) https://www.wsj.com/articles/sequoia-pares-back-china-tech-investments-as-u-s-national-security-concerns-grow.

11 Jie Yang & Aaron Tilley, *Apple Makes Plan to Move Production Out of China*, Wall St. J. (Dec. 22, 2022), https://www.wsj.com/articles/apple-china-factory-protests-foxconn-manufacturing-production-supply-chain.

12 Dawn Lim, et al., *Private Equity Slows China Investments as Biden Prepares Curbs*, Bloomberg (Mar. 6, 2023), https://www.msn.com/en-us/money/other/private-equity-slows-china-investments-as-biden-prepares-curbs.

13 *See* Treasury Dep't., Report: *Foreign Portfolio Holdings of U.S. Securities* 5 (2022) (detailing preliminary data from the June 2022 benchmark survey of foreign portfolio holdings of U.S. securities estimates of U.S. cross-border financial activity, which are collected by the Treasury International Capital (TIC) reporting system. The survey was undertaken jointly by the Treasury Department, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System. Final survey results are scheduled to be reported on April 28, 2023, and will include additional detail as well as possible revisions to the preliminary data).